 FILE 25X1

Central Intelligence Agency

DATE 9/25/86 FILE

DOC NO EA M 86-20142

OIR 3

P &PD 1

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

22 September 1986

Japan's Policy Toward the Coal Industry: Letting the Fire Go Out

25X1

Summary

Although Tokyo provides some support to Japan's inefficient coal industry--both to protect isolated mining communities and to retain Japan's most significant domestic fossil fuel source--the government has not tried to reverse the industry's decline. In fact, the upcoming report of the Coal Policy Council, a MITI advisory group, will probably recommend additional cutbacks in coal production over the next few years. In our view, financial troubles in such industries as cement, aluminum, and steel, which have been forced to buy expensive Japanese coal, as well as US pressure to meet import commitments, have encouraged the government's approach. Even with greater demand for imported coal, however, we believe other suppliers' price advantages, coupled with the growing trend of Japanese industry to burn lower quality, cheaper coal, will limit increases in US coal exports to Japan.

25X1

This memorandum was prepared by Office of East Asian Analysis. Information available as of 22 September 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Japan, Northeast Asia, OEA, . 25X1

25X1

EA M-86-20142

25X1

25X1

25X1

[redacted] 25X1

Tokyo's Policy: Protecting the Last Vestiges of an Uncompetitive Industry

For the last 25 years, MITI's Coal Policy Council has guided Japan's coal industry through a series of five-year plans. Protection for the industry has always been one element of the plans, but Tokyo has also directed sharp cutbacks in production as the industry has lost competitiveness. In the early 1960s a lively debate among business, government, and the ruling party concluded with a decision to pare back the domestic industry, originally as a way to deal with the sometimes violent, large-scale strikes that typified the industry's labor problems. Further reductions followed in 1966, when the government decided it could no longer afford the subsidies necessary to maintain coal output (see figure 1). [redacted] 25X1

The effects of Tokyo's policies were evident during 1961-75, when Japanese coal output fell from 55 million tons to less than 20 million tons and the number of miners fell by 90 percent. The pace of the decline slowed sharply after the first round of oil price hikes, however, and coal output has averaged about 16 million tons annually for several years. This pattern, in our view, reflects a reluctance to completely eliminate the country's most significant domestic fossil fuel production. Japan's economic adjustment, which resulted in greater energy efficiency and more stable energy supplies from abroad, has not erased the memory of the energy shocks of the 1970s. Moreover, the concentration of coal mining in regions where alternative employment opportunities are limited also seems to have made Tokyo unwilling to push for more cutbacks. [redacted] 25X1

Japan uses subsidies, price supports, and import quotas to enable the domestic industry to hold onto its 15-percent share of Japan's coal use:

- The government insists major Japanese coal consumers--steelmakers, aluminum producers, and power companies--purchase 20 percent of their coal from Japanese mines. Under the current system, import licenses are issued annually on the basis of projected demand. Companies probably tend to overestimate their coal demand, allowing them to actually fill over 80 percent of their coal needs from foreign sources.

- Even with their captive market, Japanese coal mines need subsidies. The central government has budgeted $797 million this year for coal-related projects--an expenditure of over $30,000 per miner. This includes $250 million for improvements in mine facilities, safety, and management. The other large expense is $375 million for environmental damage caused by coal mining. The remainder is intended to promote regional development and to assist unemployed miners.

- Tokyo uses price supports as well, fixing prices each year with the agreement of coal users and producers--generally at a level two to three times the cost of imports. Without such inflated prices, almost $1 billion in additional subsidies would be necessary. [redacted] 25X1

[redacted] 25X1

Sanitized Copy Approved for Release 2011/03/24 : CIA-RDP86T01017R000606580001-5

[redacted] 25X1

Further Declines on the Horizon

MITI's Coal Policy Council is slated this fall to release its final report recommending coal policy over the next five years. A proposal for production cutbacks is widely expected. The council's interim report issued last May called for sharp cuts in production and advocated closing eight of Japan's 11 active coal mines by 1991. The council concluded that relief measures for firms and miners displaced by future production cutbacks were preferable to subsidizing the industry at current levels. According to the US Embassy in Tokyo, most Japanese observers predict the final report will suggest reducing annual coal production to 8-10 million tons. [redacted] 25X1

Several recent developments are likely to encourage adoption of the council's recommendations:

- [redacted] The Maekawa Commission, the much-publicized Japanese study group chartered by Prime Minister Nakasone to restructure Japan's export-driven economy, has recommended cutting domestic coal production. Many of the commission's other recommendations may not be fully implemented, but we believe Tokyo will regard a decrease in domestic coal production as a relatively painless good faith effort. 25X6 25X6

- A sluggish economy caused by the yen's recent appreciation and ongoing fiscal austerity make cutting the costly subsidies to the coal industry an attractive option for Tokyo. [redacted] 25X1

In addition, yen appreciation has widened the gap between the prices of foreign and domestic coal, making it even more expensive for customers to buy Japanese. 25X1 Press reports indicate steel, cement, and aluminum producers--all of whom are being squeezed hard by the strong yen--are less willing to buy expensive Japanese coal. This year, for the first time, they have actively opposed MITI's administrative guidance to buy 25X1 a fixed percentage of domestic coal. For the steel industry in particular, [redacted] competitive pressure from South Korea is forcing the companies to opt for more low-priced imported coal. [redacted] 25X1

Tokyo theoretically could respond by cutting consumers' coal import quotas, but we believe the resulting economic damage to steelmakers would far outweigh the gains 25X1 to coal producers. MITI does have leverage over the electric power companies, however, because it has not demanded--yet--that they rebate to consumers all of their gains from lower fuel prices and a higher yen. [redacted] 25X1 Press reports indicate MITI is considering loans to coal mines to allow them to meet payrolls while discussions continue. [redacted] 25X1

Once the Council's report is issued, we expect the reduction in coal production will take five to seven years despite the strong rationale for cutting back. A gradual

[redacted] 25X1

[redacted] 25X1

approach probably appeals to Tokyo because it would space out the budgetary costs of mine closures and also further minimize political fallout from unemployment. Although mine closures would not cause huge nationwide job losses--there are only about 25,000 coal miners left in Japan--a few small coal mining communities in isolated island and mountain regions depend heavily on the industry, and we would expect concerned localities to try to slow closures. [redacted] 25X1 25X1

Japan's Coal Import Outlook: Bullish...Except for the United States

Declining domestic production is clearly in the cards, but we expect demand to increase and to be the major factor causing Japan's coal imports to grow over the medium to long term. The US Energy Information Administration, which has a good track record in forecasting Japanese energy demand, predicts about a 20-percent increase in Japanese coal use by 1995. This prediction is based largely on increased demand for steam coal, which is used primarily by electric utilities, and assumes sluggish demand for coking coal, much of which is consumed by the troubled steel industry. [redacted][1] 25X1

Even so, US coal producers are unlikely to benefit much from Japan's increased need for imported coal. We believe technology and market factors will make Japanese coal consumers increasingly cost conscious. US cost disadvantages already have reduced the US market share to 20 percent (see figures 2 and 3). Although US mines have lowered their prices over the last three years, their prices remain slightly above those of Canadian producers--and significantly above Australian prices--primarily because of higher transportation costs. Even then, combined with the dollar's recent depreciation against the yen, decreasing US prices have not offset the cost edge enjoyed by the Australians and Canadians. [redacted] 25X1

25X1 Technological advances are also making low-cost coal more attractive, lessening the quality advantage heretofore enjoyed by US coal. [redacted] 25X1 25X1 25X1 In addition, the expected long-term drop in demand for coal from Japan's declining steel industry will probably mean that steam coal--rather than coking coal, the major US export--will take the lion's share of any rise in sales. [redacted] 25X1

The Japanese purchasers' long-term relationships with Canadian and Australian producers also will probably argue against future increases in US sales. For instance, [redacted] Japanese buyers have been willing to pay a premium 25X1 25X1

---

[1] In the short term, we do not expect low oil prices to have much effect on demand for coal in Japan. [redacted] Japanese energy consumers are reluctant to switch from coal to oil use because they believe the price of oil will rise is, in our view, an accurate reflection of Japanese attitudes. [redacted] 25X1 25X1

[redacted] 25X1

[redacted] 25X1

for coal from new Canadian mines, anticipating the time when these mines will be operating at full capacity, increasing production and driving prices down. Furthermore, Japanese firms have been investing heavily in Canadian and Australian coal mines, largely as a strong guarantee of future "energy security." Although their ownership shares in individual mines are small, we believe the Japanese stake may make them hesitant to lower future purchases, particularly if such action would leave the mines operating at less than full capacity. [redacted] 25X1

Despite the generally bleak long-term outlook for increased US coal exports to Japan, the picture for this year looks relatively good. MITI officials told the US Embassy in Tokyo that total coking coal imports will probably reach 10.8 million tons in the fiscal year ending next March. [redacted] 25X1

[redacted] 25X1

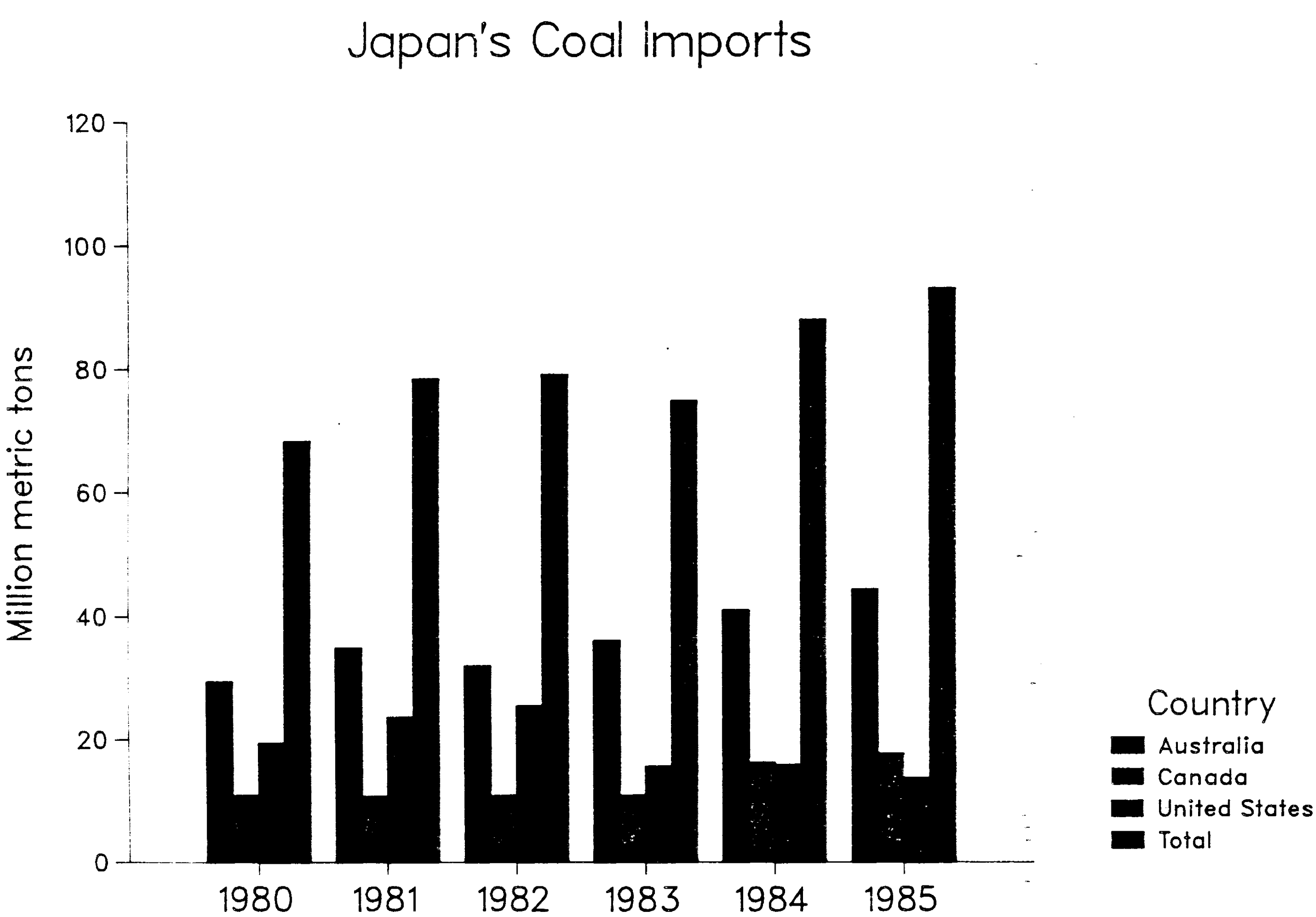
[redacted] 25X1

FIGURE 1

Japan's Domestic Coal Production

25X1

Figure 2



25X1

Figure 3

Coal Prices Paid by Japanese Firms (by Source)*

	1980	1981	1982	1983	1984	1985	1986
Domestic	123				98	93	120
United States	81.3	82.4	83.2	78.1	70.6	68.8	62.5
Canada	62.2	64.6	70.1	70.1	69	67.5	60.2
Australia	59.2	65.6	67.6	61.8	57	52	48.3

*Dollars per ton.

25X1

[redacted] 25X1

SUBJECT: Japan: Japan's Coal Industry: Letting the Fire Go Out [redacted] 25X1

Distribution:

Original – OEA/NEA/Japan Branch
1 – Donald Gregg, Assistant to the Vice President
1 – Thomas Hubbard, Director, Office of Japanese Affairs/State, 4206
1 – Charles Kartman, Deputy, Office of Japanese Affairs/State, 4206
1 – William Brooks, INR/EAP/Japan
1 – Nick Riegg, INR/EB
1 – Bob Reis, Japan Desk/State
1 – William Piez, Deputy Assistant Secretary, Bureau of East Asian and Pacific Affairs/State
1 – Steve Danzansky, Staff Member NSC
1 – [redacted] 25X1
1 – [redacted]
1 – [redacted]
1 – Byron Jackson, Office of Intelligence Liaison/Dept. of Commerce
1 – Maureen Smith, Japan Desk/Dept. of Commerce
1 – Suzanne Early/USTR
1 – Joe Massey, Assistant Trade Representative
1 – Doug Mulholland, Office of the Special Assistant to the Secretary for National Security/Dept. of Treasury
1 – William Barreda, Director Office of International Trade/Dept. of Treasury
1 – [redacted], National Security Agency 25X1
1 – Bob Bidwell, Dept. of Energy
[redacted] 25X1
1 – D/DCI/DDCI Executive Staff, 7D60
1 – NIO/EA, 7E62
1 – NIO/Economics
1 – C/PPS/DO (DO1)
1 – C/EA [redacted] 5E18 25X1
1 – OGI/IIC/PI
1 – DDI
1 – D/OEA, 4F18
1 – Senior Review Panel, 5G00
1 – PDB Staff, 7F30
5 – CPAS/IMC/CB, 7G07
1 – CPAS/ILS, 7G50
1 – OEA/NEA/Korea Branch
1 – OEA/NEA/STI Branch
1 – OEA/NEA Division
1 – OEA/SEA Division
1 – C/Production Staff
1 – FBIS Analysis Group

[redacted] 25X1

Sanitized Copy Approved for Release 2011/03/24 : CIA-RDP86T01017R000606580001-5

25X1

DDI/OEA/NEA/Japan/[redacted] (19 September 1986) 25X1

25X1